



## Top Proven Principles

# for Successful Revenue Forecasting

Your ability to predict future revenue says a lot about your likelihood to minimize risk, capitalize on opportunities, and create a consistent, trustworthy performance for investors and consumers. Companies that can't answer "How do you expect to perform this year?" leave themselves open to doubt, disjointed company efforts, and loss of investor confidence.

But how do you accurately predict revenue for a growing company during an unprecedented and unsteady global economy? We'll give you a rundown of critical components, how to tell if your methods give you the information you need and top tools to empower your revenue forecasting.

## What is Revenue Forecasting, and Why Do It?

Revenue forecasting is the method of predicting future sales within a defined period, usually quarterly or annually. The point isn't to set a sales goal or to fund a best-case-scenario budget.

Far from a crystal ball, a quality revenue forecasting model reasonably defines the near future for your products against your competition and expenses in a relatively known economy.

A few common but powerful points of impact include:

- Daily cash flow management.
- Meaningful projections for investors.
- Managing sustainable business growth.
- Creating reliable plans for the unexpected.





# 7 Steps to Creating a Valuable Forecast

There are multiple ways to create your revenue projections; however, most incorporate the following seven steps.

## 1. Define the forecast period.

Forecasting is a valuable tool when the period is close enough that you can reasonably predict with detail. So while you can create reasonable sales goals five or ten years ahead, those goals differ from revenue forecasts.

It's a good idea to have both quarterly and annual revenue forecasts. Quarterly reports are more likely to be accurate and will create checkpoints for your yearly forecast. The annual forecast will help you to maintain a larger picture and keep company growth on track.

## 2. Set the scene for your company, product/ service, competition, and economy.

An excellent revenue forecast accurately predicts sales because it accounts for the current environment. However, your revenue forecast turns into an uninformed goal without a clear understanding of the following:

- Your company position
- The performance of your product or service
- The relative pressure of the competition
- Economic implications like supply chain, inflation, and interest rates.



### 3. Estimate direct and indirect expenses.

Decade after decade, insufficient cash flow continues to be a top reason for business failure. As a result, many companies struggled to understand the required capital for growth against their ability to make sales. However, forecasts must include direct and indirect costs, which often mix fixed and variable costs.

**Direct costs** include categories like employee compensation, manufacturing costs, and raw material prices.

**Indirect costs** include categories like office rent, technology, and utilities.



### 4. Project expected sales with a nuanced vision.

Your expected sales will incorporate past performance with new products or features, an understanding of your ideal client base, and the ability for the competition to disrupt your market share.



## 5. Integrate predicted expenses and sales into a detailed, unified report.

You have enough information to create an integrated revenue forecast at this stage. Your forecast should have a high-level summary and detailed information about how your numbers come into play.

A clear summary allows company leadership to make clear decisions. At the same time, the detailed notes clarify questions and identify which points are irrelevant as time goes on.

## 6. Test the validity of your forecast with proven financial ratios.

Your forecast will only be complete with proper testing. Your first round of testing will include using financial ratios, like profitability and efficiency ratios. Testing with ratios will ensure that your forecast uses solid financial principles and that the underlying assumptions are accurate.

## 7. Test the validity of your forecast with “what if” scenarios.

Finally, test your forecast by using simulated “what if” scenarios. Your forecast should be able to process new information and give you new benchmarks. Without an adaptable forecast, you’ll essentially have an elevated sales goal.





# Methods to Forecasting

While the basic steps are essentially the same for all revenue forecasting methodologies, there are a few common approaches. We'll cover bottom-up, top-down, and backlog methods here.

## Bottom-up

A [bottom-up approach](#) is commonly used across company financial analytics. You will start with low-level data and work upward to generate revenue.

Companies often start at the product or service level, using historical data to predict future demand. Next, they will factor in the real revenue of sales after promotions and discounts. Finally, they will use the expected sales volume with the real revenue per product to determine forecasted revenue.

## Top-down

The reverse approach is also commonly used to predict revenue, where companies estimate their claim of the available market share.

Step one is calculating your Total Available Market (TAM) across all your product and service offerings. Next, you'll estimate your percentage claim of the TAM in each category. Finally, you'll calculate revenue by multiplying your percentage market share by the TAM.

You can customize your numbers by adding volume, sales price, and other factors.



## Backlog

Companies with subscription services often benefit from backlog revenue forecasting. However, backlog revenue methodology relies heavily on unrealized revenue from existing client contracts.

Backlog revenue forecasting doesn't focus as much on uncertainty, and with good reason. For example, subscription contracts are much more difficult to cancel and provide perpetual income rather than depending on unique sales or increasing your client base.

# Use the Best Tools to Empower Your Financial Forecasting

While understanding correct principles and methodologies is essential to valuable forecasts and reports, using the best tools will vastly improve your success rates. Great financial analysis software will use robust reporting, real-time updates, quality and access controls, and clear reports for empowered decision-making.

At Cofi, we provide high-quality software with live integrations, forecasting abilities, and much more. If you want the easiest way to forecast revenue, I highly recommend giving Cofi a try.

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